

Testimony of the Honorable Brian E. Sheridan
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PANAMA AND THE FUTURE OF THE PANAMA CANAL

Mr. Chairman, I am very pleased to appear before the committee today to discuss the operation and security of the Panama Canal after the United States relinquishes control of the waterway at the end of this calendar year.

Although Canal access and defense are assured by treaty, questions have been raised about whether the U.S. can maintain unimpeded rights to passage and effectively guarantee the Canal's continued operation once title passes to the Panamanian government on December 31, 1999. In particular, questions have been raised by reports of Panama's award of port concessions adjoining the Canal to a Hong Kong-based conglomerate, Hutchison Ports Holdings, a wholly-owned subsidiary of Hutchison Whampoa, Limited (HWL). Some have wondered whether HWL, operating through its subsidiary, the Panama Ports Company (PPC), foreshadows a growing and potentially inappropriate role for China in control and operation of the waterway.

The Defense Department believes adequate safeguards are in place to protect U.S. military and commercial interests in the Canal. Let me begin with a bit of history viewed through conditions we face today.

As the Members of this committee are aware, the commitment to negotiate an end to U.S. sovereignty in the Canal Zone began in 1964 and involved more than a decade of lengthy and complex negotiations leading to the Panama Canal Treaty, as well as the Treaty Concerning the Permanent Neutrality and Operation of the Panama Canal in 1977. Both the United States and Panama are assiduously working toward full implementation of the Panama Canal Treaty. Article XIII (1) of the Treaty provides that, upon termination of the treaty at noon December 31, 1999, the Panamanian government "shall assume total responsibility for the management, operation, and maintenance of the Panama Canal, which shall be turned over in operating condition and free of liens and debts." Furthermore, Article XIII of the Panama Canal Treaty provides that the U.S. will transfer to Panama "without charge... all rights, title and interest" we have "with respect to all real property, including non-removable improvements thereon" that were used by the Panama Canal Commission or U.S. military forces. In other words, to the extent that the U.S. holds title or use rights to properties covered by the Treaty, all these rights will automatically transfer to the Panamanian government on December 31, 1999.

The Department of Defense is implementing the terms of the Panama Canal Treaty arranging for the transfer of Defense facilities and withdrawing U.S. forces. Transition

activities are proceeding successfully under the Panama Canal Treaty Implementation Plan, signed by the Secretary of Defense in 1992. In consultation with the Government of Panama, U.S. officials have planned and coordinated the return of all property by the Treaty deadline. By December 31, 1999 the U.S. will have transferred property comprising 77,000 acres and 4,272 buildings to the Government of Panama. It is up to Panama to decide the ultimate utilization of these properties.

The U.S. strategic interest in Panama is the efficient and secure operation of the Canal itself. Although the development of alternative intermodal routes for some commodities has reduced the importance of the Canal for U.S. commerce, the Canal is still highly important to Pacific Rim countries and to the United States. Thirteen percent of U.S. international shipborne commerce transits the Canal. Four percent of world trade passes through the Panama Canal, for a total of more than 14,000 crossings in 1998. Our interest in ensuring that the Canal remains open and secure to ships of all nations will not end with its transfer to the Government of Panama.

In recognition of the U.S. role in developing the waterway, the Neutrality Treaty provides that U.S. vessels of war and auxiliary vessels will continue their entitlement to expeditious transit, which means that they will always be allowed to pass through the waterway as quickly as possible and without impediment, with expedited treatment, and in case of need or emergency, to go to the head of the line. Neither Hutchison Whampoa's presence in Panama, nor any other commercial arrangements made by the Panamanian government, will impact on U.S. naval vessels' current privileges in Canal transit nor override Treaty commitments.

One special safeguard that will ensure the continued efficient operation and security of the Canal after its transfer to Panama should also be mentioned. As part of the ratification process of the Treaty on the Permanent Neutrality and Operation of the Panama Canal, then U.S. Senator Dennis DeConcini (D-AZ) added a reservation stating in part "... if the Canal is closed, or its operations are interfered with, the U.S. and the Republic of Panama shall each independently have the right to take such steps as each deems necessary... including the use of military force in the Republic of Panama, to reopen the Canal or restore the operations of the Canal, as the case may be." The Treaty provides that the United States may protect the Canal with force if need be. We take this commitment seriously and remain vigilant to any possible threat, now and in the future, to the safe, open and neutral operation of the Canal.

Numerous questions have arisen about the involvement of the People's Republic of China in the commercial concessions obtained by the HWL subsidiary Panama Ports Company for the operation of container terminal facilities at either end of the Canal. The Department of Defense would like to clarify for the Committee what we know about the

nature of the PPC contract and its potential impact on free and safe passage through the Panama Canal.

HUTCHISON-WHAMPOA AND PANAMA

In 1996, HWL's Panama Ports Company (PPC) successfully bid for a 25-year concession to develop terminals at Balboa and Cristobal port facilities on either end of the Canal. The PPC bid provides specifically for the PPC to pay the government of Panama: \$22.2 million annually in rent; loan \$30 million, interest-free, for seven years; to provide severance pay to Canal workers; and 10% of gross revenues. In addition, the PPC will pay the government of Panama \$10 million for all existing equipment currently at the port facilities; invest no less than \$50 million for the next five years in port upgrades; and give the government of Panama 10% shareholding in the PPC.

Cooper T. Smith Kawasaki Shipping Partnership submitted the next closest bid for \$10 million, and reportedly, Bechtel submitted an initial bid for \$5 million but dropped out in the final round. In January 1997, the contract between PPC and the government of Panama was approved by the Panamanian legislature as Law No. 5.

The PPC is 90 percent owned by Hutchison Port Holdings, a wholly owned subsidiary of Hutchison Whampoa, Limited, and the remaining 10 percent is owned by the Port of Panama, a separate organization from the Panama Canal Authority, the entity charged with running the Canal after transfer. HWL, established in 1860, is one of Hong Kong's oldest British trading companies that was acquired in 1979 by Li Ka-Shing. According to company reports, Cheung Kong Holdings, Li Ka-Shing's flagship company, owns 49.9 percent of HWL. Li Ka-Shing and his family currently own 34.9% of Cheung Kong. There is no public record of any mainland ownership of any of the above corporations either through direct investments or through membership on boards of directors. While the Hong Kong government owns 8-10 percent of Cheung Kong holdings and HWL as a result of its 1998 stock market intervention, it also has similar stakes in most of Hong Kong's other blue chip companies.

HWL is one of the world's largest container operators, with port operations at 18 locations around the globe. According to the company's latest figures, it handles around 10 percent of global container traffic, a significant portion of which is represented by its operation in Hong Kong. Li Ka-Shing's corporate interests extend well beyond China. At present, the market capitalization of Cheung Kong, HWL and their affiliated companies, totals nearly \$80 billion, \$6 billion of which is invested in mainland China.

Our analysts believe that HWL's primary interest in bidding on the Panamanian ports was to establish a Pacific Ocean hub for its shipping interests. There are two major sites, Balboa and the former Rodman US naval base, worthy of the investment necessary

to make a major port on the Pacific side of the Canal. HWL obtained the rights to Balboa on the east bank, and the right of first refusal to the Rodman facilities, although Alireza-Mobil is operating a bunkering facility there at the present time. At the insistence of the Panamanian government, HWL also agreed to develop a port on the Caribbean side at Cristobal, in order to obtain the Balboa concession.

The Panama Canal and the ports at either end, of which Cristobal and Balboa are only two, are separate and distinct entities. Ships transiting the Canal are not required to go through the PPC properties or use its port services. The PPC is not the only foreign entity that operates ports in the vicinity of the Canal. A U.S.-owned subsidiary of Stevedore Services of America, Manzanillo International Terminal, and the Taiwanese company, Evergreen International, have their Latin American hubs in the Colon Free Trade Zone at the northern mouth of the Canal and are the dominant port facilities on the Caribbean side. Together, these entities process 90 percent of container traffic on the Atlantic side, ensuring free competition and insulating the organization and operation of the Canal from improper influence and interference.

Operation of the Panama Canal remains with the Panama Canal Authority (PCA). The contract between the Panama Ports Company and the government of Panama is a contract of operation and maintenance of two ports adjacent to the Canal. There is nothing in this contract that directly relates to the security and future operation of the Canal. It is important to note the subordinate relationship of Law Number 5 to the Panama Canal Authority Organic Law, and the Panamanian Constitution. The PCA Organic Law guarantees that all operations within the Canal and its anchorages, moorings, and ports in the areas outside the Canal operating area are subject to the supervision and control of the PCA. Annex 10, Article 2 of Law 5 clearly states that Panamanian Canal Authority Organic Law pertaining to Canal operations will prevail over Law 5 in case of conflict. Moreover, under Panamanian law, treaties and international agreements have precedence over domestic laws -- including Law 5.

The PPC contract with Panama does not give the PPC the right to control anchorages on either end of the Canal. The contract allows the PPC to develop, construct, operate, administer, and manage the port facilities at only two of five ports in Panama. All vessels or craft transiting or moving in the Canal water or anchorages are subject to the orders and control of the PCA. While the PPC has the authority to train its own pilots to bring ships from anchorage into its container port, these “company pilots” may not pilot a vessel through the Canal, as that is a job reserved for the certified Panama Canal Authority pilots. However, in order to assure efficient operation the PPC obtained guarantees of coordination and the right for its pilots to accompany the PCA pilots transiting the Canal.

Questions have been raised about a provision of Law 5 that accords the PPC a three-year right of first refusal for development of a container port at the Rodman naval station. This right expires in a few months (April 2000) and, to date, has not been exercised by the PPC. Our analysts have no indications that the PPC is planning to expand to develop the former Rodman naval station into a container port facility. Moreover, there are other Pacific sites available for development by competing firms.

CONCLUSION

The concessions granted to the PPC do not limit or hinder military or commercial traffic or represent any greater threat to the Panama Canal than the 200+ annual Canal transits by Chinese flag vessels. The neutrality of the Canal and its operations are guaranteed by the Treaty Concerning the Permanent Neutrality and Operation of the Panama Canal signed and ratified by the Governments of the United States and Panama, and also by the Treaty's Protocol, to which 36 other countries are state parties.

The evidence we have does not suggest that evidence China, through Hutchison-Whampoa or any other firm, has the capability, the desire, or the wherewithal to seek to control the Panama Canal after its transfer to Panama on 31 December 1999. In the judgement of our analysts, Hutchison-Whampoa's motivations are commercial. Existing Panamanian Law and Treaties provide the United States ample assurance and recourse to ensure that the Canal remains open and secure for world commerce. We will maintain close attention to Canal Operations after the transfer and will keep you informed in the unlikely event our assessment changes.

Thank you, Mr. Chairman.